A Review of the State of Nevada's Debt Affordability Measures: Separating Fact and Fiction

There have been several published reports this year that have erroneously reported on the debt burden faced by states, and specifically Nevada. In June, for instance, CNN Money's website reported on the most recent report published by Meredith Whitney. In their story, CNN Money stated, "Today, debt service absorbs half of Nevada's budget."

This statement is clearly false. As accurate financial information provided to the public, investors and market analysts, is extremely important, this document presents an accurate picture of the State of Nevada's total amount of general obligation (GO) debt issued and its debt service costs.

Debt Affordability Measures

"Debt service" is simply the annual principal and interest payments due in any particular year on bonds or other debt issued by an entity. A traditional measure of the affordability of an entity's debt is to compare an entity's annual debt service to its annual revenue or budget. This metric measures how much of an agency's annual budget goes to pay debt service and seems to be the emphasis of the CNN Money article.

There are two relatively standard ways to compute this debt affordability measure. The first is to compare total debt service against an entity's total budget. This following chart highlights the State of Nevada's percentage of debt service on this basis:

	FY09	FY10
Total G.O. Bond Debt Service	$ 258,455,223	$ 255,716,135
Total State General Fund Budget	$ 7,794,653,000	$ 7,497,728,926
Pct of Total	**3.3%**	**3.4%**

The State of Nevada's total debt service ranged from $255.7 to $258.5 million per year in Fiscal Years 2009 and 2010, the two most recently completed fiscal years. As a percent of the total General Fund budget, debt service represents a small fraction of the budget, approximately 3.4% in FY 2010.

A second debt affordability measure is to analyze a state's net debt service on its general obligation debt. This takes the total debt service and subtracts any offsetting revenues the state receives; the difference is the net debt service the state pays through its property tax collections (In Nevada, currently 17 cents per $100 of assessed valuation) or other discretionary General Fund revenues. This net debt service is then compared to the amount of the unrestricted General Fund budget. In Nevada's case:

	FY09	FY10
Total Non-Self Supporting G.O. Debt Service	$ 180,086,138	$ 178,296,880
Unrestricted General Fund Budget	$ 3,726,608,000	$ 3,178,264,000
Pct of Total	**4.8%**	**5.6%**

Again, based on this second debt affordability measure, Nevada's debt service represents a very small portion of the State's discretionary revenues, approximately 5%.

Combining Debt Service and other Long-Term Liabilities

In the last several years, there have been many news reports that have reported on states' and local governments' pension costs and other long-term liabilities. In response, several credit rating agencies have begun to combine pension liabilities with agencies' debt burden in analyzing governments' long-term liabilities. We understand that some of the analyses done by Meredith Whitney and others have similarly commented on these combined liabilities.

In the table below, we compare the combined annual expense of Nevada's debt service, contributions to the state employee pension system, and its contributions to the Public Employees Benefits Program (PEBP) for health insurance costs for current employees and retirees to the Total General Fund Budget.

	FY09	FY10
Total Non-Self Supporting G.O. Debt Service	$ 180,086,138	$ 178,296,880
Pension Contributions to NVPERS	$ 153,768,000	$ 164,630,000
PEBP Contributions - Employee & retiree benefits	$ 212,081,106	$ 229,628,416
Total Debt + Pension + PEBP	$ 545,935,244	$ 572,555,296
Total State General Fund Budget	$ 7,794,653,000	$ 7,497,728,926
Pct of Total	**7.0%**	**7.6%**

Once again, even after combining all of these costs, the combined costs represent a small portion of the overall State budget, not as the CNN Money story portrays as, "half of the budget."

State's Total Long-Term Liabilities

The above two approaches use an apples-to-apples comparison of the annual cost to the State of its debt service and in the second section, its combined debt, pension, and health insurance liabilities to its annual budget, which is equal to the State's income. Such an approach is analogous to the traditional debt affordability measures used by mortgage lenders in determining whether a family can afford a house payment. The mortgage lender will compare a family's annual mortgage payment to its annual income.

As is shown above, Nevada's debt load represents a very small percentage of its income. This is why all three credit rating agencies have characterized Nevada's debt as modest to moderate and below the median of states.

At the same time, it may also be useful to look at an entity's total debt and long-term liabilities. In 2011, Moody's issued a report entitled, "Combining Debt and Pension Liabilities of U.S. States Enhances Comparability", in which Moody's compared states' long-term liabilities against total state personal income, GDP, population, and as a percentage of state revenue. Nevada ranked #37, #40, #40, and #27 respectively in terms of having the lowest debt burden based on these measures.

Nevada's total outstanding debt is $2.24 billion as of November 1, 2010. Of this, $661.77 million is self-supporting debt and is not paid by General Fund discretionary sources. The remaining $1.579 billion is the amount of outstanding non-self supporting GO debt.

The State of Nevada is one of many governmental entities covered by the Nevada Public Employees Retirement System (NVPERS). The percent of covered employees in NVPERS that are state employees is approximately 16%. Using this percentage, the State's share of NVPERS' unfunded pension liability as of June 30, 2010 is approximately $1.66 billion. In Nevada, state employees pay half of the State's pension costs, so the State's share of this $1.66 billion is approximately $828 million.

The ratio of these combined long-term liabilities to the total General Fund budget is 32%.

Total Outstanding GO Bonds	$ 2,241,700,000
Less Self-Supporting Debt	$ (661,770,000)
State's Portion of NVPERS Unfunded Accrued Actuarial Liability (UAAL)	$1,656,368,000
Less State Employee's Share (50%)	$ (828,184,000)
TOTAL	$ 2,408,114,000
FY2010 General Fund State Budget	$ 7,497,728,926
Pct of Total	32.1%

This kind of approach is like comparing a family's income of $100,000/year to the total owned on their home of $200,000 and arguing they cannot afford that home because the debt is twice their income. The true affordability measure is to compare one's annual obligations compared to one's annual income. Nevertheless, this appears to be the methodology used by many outside commentators of the municipal bond industry, who have portrayed this to the public as "analysis."

In contrast to such an approach, Moody's computed these measures in its report primarily as a way to compare and rank states on a relative basis. This approach is justifiable and on that basis, Nevada ranks in all measures below the median of states and in most cases in the top quartile.

Conclusion

The State of Nevada has used a fiscally conservative approach when issuing debt. At least once a year, the State Treasurer's Office prepares a debt affordability study in which it compares future GO bond debt service against forecasted receipts of the State's 17-cent share of property taxes. Even with the significant drop in the housing market in Nevada and the resulting dramatic declines in statewide assessed valuation, the State can pay all of its debt service with an adequate reserve set aside. Currently, the State has set aside almost a full year's worth of debt payments in reserves.

All three major credit rating agencies have cited the State's modest level of debt and fiscally conservative budget and debt practices as key reasons for the State's high "AA" credit rating. Statements such as "debt service absorbs half of Nevada's budget" are clearly erroneous and in our view, represent irresponsible reporting.